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IN THE

Supreme Court of the United States

October Term, 1962

No. 78

CHESTER A. PEARLMAN, Trustee,

Petitioner,

vs.

RELIANCE INSURANCE COMPANY,

Respondent.

RESPONDENT'S REPLY BRIEF TO BRIEF OF AMICUS CURIAE EDWARD M. MURPHY

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INDEX

	PAGE
Introductory Statement	1
Discussion	2
1. "Equality of Distribution" of a bankrupt's estate does not apply to "Trust Assets" of which the bankrupt was not the beneficial owner	2
2. The \$87,000 fund is the "Réés" or Fund to which the Respondent's rights attached prior to bankruptcy	4
Conclusion	7

TABLE OF CASES CITED.

American Surety Company of New York v. Sampsell, 327 U. S. 269, 66 S. Ct. 571 (1946)	6
American Surety Company of New York v. Westinghouse Electric Mfg. Co., 296 U. S. 133, 56 S. Ct. 9 (1935)	6
Belknap Hardware Co. v. Ohio River Co., 271 Fed. 144 (C. A. 6, 1921)	6
City of Dallas v. Crippen, 171 Fed. (2) 526 (C. A. 5, 1948) cert. denied 336 U. S. 937, rehearing denied 336 U. S. 955	2
Dillon v. Barnard, 21 Wall. 430	5, 6
<i>In Re</i> Empire Granite Co. Inc., 42 Fed. Supp. 450, 453-454 (D. C. Georgia 1942)	3
Fidelity and Deposit Company of Maryland v. New York City Housing Authority, 140 Fed. Supp. 298 (D. C. N. Y. 1956)	3
<i>In Re</i> Franklin Savings & Loan Co., 34 Fed. Supp. 661, 664 (D. C. Tenn. 1940)	3
Martin v. National Surety Co., 300 U. S. 588, 593-594 (1937)	2, 6
Massachusetts Bonding and Insurance Company v. State of New York, 259 Fed. (2) 33, at pages 36-38 (C. A. 2, 1958)	3
McKey v. Paradise, 299 U. S. 119	5, 6

II.

PAGE

Philadelphia National Bank v. McKinlay, 72 Fed. (2) 89, 91 (C. A. D. C. 1934), cert. denied 293 U. S. 583	2, 6
Sexton v. Kessler & Co., 225 U. S. 90 (1912)	4, 5
United States v. Bess, 357 U. S. 51 (1958)	3
United States v. Durham Lumber Co., 363 U. S. 522 (1960)	3
Whiting v. Hudson Trust Co., 234 N. Y. 394 (1923)	3

STATUTE.

Bankruptcy Act	2, 4
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RESPONDENT'S REPLY BRIEF TO BRIEF OF *AMICUS CURIAE* EDWARD M. MURPHY

Introductory Statement

This reply brief is submitted pursuant to leave granted by this Court upon the oral argument on October 9, 1962.

On October 8, 1962, this Court granted the application of Edward M. Murphy of Roseburg, Oregon to file a brief *amicus curiae* in support of the petitioner. Mr. Murphy's brief had not been filed or served at the time of the argument, and this Court granted leave to respondent to file a brief in reply to Mr. Murphy's brief. Mr. Murphy's brief was received by the undersigned on October 19, 1962.

Discussion

We have now read the *amicus curiae* brief submitted by Mr. Murphy.

The arguments advanced would seem to fall into two (2) categories:

1. The "equality of distribution" under the Bankruptcy Act.
2. The lack of a "res" or fund to which the rights of the respondent could attach.

"Equality of Distribution" of a bankrupt's estate does not apply to "Trust Assets" of which the bankrupt was not the beneficial owner.

In *City of Dallas v. Crippen*, 171 Fed. (2) 526 (C. A. 5, 1948) cert. denied 336 U. S. 937, rehearing denied 336 U. S. 955, the Fifth Circuit wrote at page 529:

"If the bankrupt holds property in trust for another, the trustee in bankruptcy takes title to such property charged with the trust. So long as the property can be identified according to sound trust doctrines of tracing and identification, it will be treated in bankruptcy as property to which creditors of the bankrupt have no claim, and will be paid over as a whole before disbursements are made to lienholders or unsecured creditors. Matters of this kind have no relation to priorities under Sec. 64, sub. a, 11 U. S. C. A. 104, sub. a."

To the same effect are:

Philadelphia National Bank v. McKinlay, 72 Fed. (2) 89, 91 (C. A. D. C. 1934), cert. denied 293 U. S. 583;

Martin v. National Surety Co., 300 U. S. 588, 593-594 (1937);

Massachusetts Bonding and Insurance Company v. State of New York, 259 Fed. (2) 33, at pages 36-38 (C. A. 2, 1958);

In Re Empire Granite Co. Inc., 42 Fed. Supp. 450, 453-454 (D. C. Georgia 1942);

In Re Franklin Savings & Loan Co., 34 Fed. Supp. 661, 664 (D. C. Tenn. 1940);

Whiting v. Hudson Trust Co., 234 N. Y. 394 (1923).

Counsel, on page 4 of the Murphy *amicus* brief, cites *Fidelity and Deposit Company of Maryland v. New York City Housing Authority*, 140 Fed. Supp. 298 (D. C. N. Y. 1956), in support of his contentions. He apparently failed to note that on appeal this case was reversed in 241 Fed. (2d) 142 (C. A. 2, 1957), and that the Court of Appeals Opinion was cited with approval by this Court in *United States v. Bess*, 357 U. S. 51 (1958) and in *United States v. Durham Lumber Co.*, 363 U. S. 522 (1960), as set forth on page 20 of our main brief.

It must be remembered that the entire fund in question, amounting to \$87,000, arose out of labor and materials ordered and placed by the bankrupt on its St. Lawrence Seaway prime contract prior to April 11, 1962 (Item 12 of Agreed Statement of Facts T. R. page 23). But it must also be remembered that the respondent, pursuant to its obligation under the payment bond, paid these labor and material bills aggregating \$349,000 (Item 9 of Agreed Statement of Facts T. R. page 22), *an amount four times as great as the \$87,000 fund in controversy*. And, finally, *that there are no known unpaid job creditors on this job* (T. R. page 22).

In its amended proof of claim (T. R. pp. 41-44) respondent asserted its right to the fund " * * * by way of liens,

subrogation and assignment, * * * (T. R. page 43) to the entire balance of moneys payable under the bankrupt's prime contract on the St. Lawrence Seaway job.

Here is a fund to which the contractor, here represented by the petitioner, its trustee in bankruptcy, contributed nothing from the general assets of the bankrupt's estate.

We respectfully suggest that the "equality of distribution" rule of the Bankruptcy Act does not *require* the fund to be distributed to general creditors who contributed nothing to the creation of the fund. Indeed, in simple fairness, equity and justice the fund should be awarded to the respondent.

The case of *Serton v. Kessler & Co.*, 225 U. S. 90 (1912), cited on page 4 of the Murphy *amicus* brief, supports, rather than detracts from, the position of the petitioner.

The \$87,000 fund is the "Res" or fund to which the Respondent's rights attached prior to bankruptcy.

We respectfully urge that consideration of the following facts clearly indicate the known presence of a specific "res" long prior to bankruptcy.

1. The execution of the payment bond in which the Contractor, here represented by the Petitioner, its Trustee in Bankruptcy, was principal and the Respondent was Surety, on April 11, 1955 (T. R. pp. 17-18).

2. That prior to the termination of the bankrupt's contract on April 11, 1956 the bankrupt had furnished labor and materials to the extent of \$127,000 (but failed to pay for them), from which all parties agreed \$40,000 should be deducted, leaving the \$87,000 fund here in question (Items 14-16 of Agreed Statement of Fact T. R. pp. 23-24).

3. That during the Spring and Summer of 1956, the Surety, pursuant to its obligations under the payment bond, paid these unpaid job creditors \$326,248.42; and, in addition, paid other job creditors additional sums, bringing the Surety's total claim payments up to \$349,172.81; that as a result of these payments there then remained "no known unpaid laborers or materialmen" on the bankrupt's prime contract (Items 8-9 of Agreed Statement of Facts T. R. pp. 21-22).

4. That as a result of the foregoing, the \$87,000 fund came into the hands of the Petitioner as a clearly identified fund or "res" (Item 16 of Agreed Statement of Facts T. R. p. 24).

Granting for the sake of the argument that, "whether enough has been done to give a right of any kind in certain property is a question of more or less" (*Sexton v. Kessler & Co.*, 225 U. S. 90 (1912)), we respectfully urge that under the circumstances here present there was a clearly identified "res", *viz.*, the \$87,000 now in the hands of the Petitioner, which is the subject of this appeal.

We have already commented upon the *Sexton* case (225 U. S. 90), cited on page 4 of the Murphy *Amicus* brief. With respect to *McKey v. Paradise*, 299 U. S. 119, and *Dillon v. Barnard*, 21 Wall. 430, we suggest they are not in point here.

In the *Dillon* case (21 Wall. 430) it would seem that the basic question was whether a contractor who furnished labor and material to the owner of real property, with knowledge of a pre-existing mortgage on the property, could assert a lien or claim on the real property ahead of the prior mortgage. The answer of this Court quite properly was that the mortgage lien was superior.

On page 5, the Murphy *amicus* brief quotes from the *Dillon* case (21 Wall. 430, 440) the phrase "disappointed expectations against which misfortune equity furnishes no relief." The *Dillon* case was decided in 1874 and in a somewhat different setting.

We respectfully suggest that, in situations similar to those in the case at bar, the Courts, when the "chips are down", so to speak, have seen to it, with considerable uniformity, that the claims of job laborers and materialmen have been paid to the full extent of any and all available job contract moneys to the exclusion of other general creditors. For the most part their "expectations" were not "disappointed". In the following cases their "expectations" were realized to the fullest extent possible:

Belknap Hardware Co. v. Ohio River Co., 271 Fed. 144 (C. A. 6, 1921);

Philadelphia National Bank v. McKinlay, 72 Fed. (2d) 89 (C. A. D. C. 1934), cert. denied 293 U. S. 583, 55 S. Ct. 96;

American Surety Company of New York v. Westinghouse Electric Mfg. Co., 296 U. S. 133, 56 S. Ct. 9 (1935);

Martin v. National Surety Co., 300 U. S. 588, 57 S. Ct. 531 (1937);

American Surety Company of New York v. Sampsell, 327 U. S. 269, 66 S. Ct. 571 (1946).

In the *McKey* case (299 U. S. 119) the question was whether an employer who had agreed to set aside, *out of admitted general assets then in his possession*, a special fund for the benefit of his employees, but who failed to do so before bankruptcy, had so far segregated or dedicated any specific fund or "res" so as to create a trust or "res" for the benefit of the employees which was bind-

ing on the employer's trustee in bankruptcy. This Court properly held there had not been a sufficient identification or segregation to permit the carrying out of the employer's plan.

In the case at bar the \$87,000 fund, *long before it reached the hands of the trustee*, the petitioner herein, was clearly and specifically known and identified.

Conclusion

We respectfully submit:

1. We do not reach the question of the "equality of distribution" rule urged by the Murphy *Amicus* brief, inasmuch as the \$87,000 fund came into the hands of the Petitioner, the Contractor's Trustee in Bankruptcy, charged with the known paramount equity in favor of the Respondent.
2. The "res" is the \$87,000 fund, clearly known and identified long before bankruptcy.
3. The determination of the Court of Appeals should be affirmed, and the fund ordered turned over to the Respondent.

Respectfully submitted,

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I HEREBY CERTIFY that I have served a copy of the foregoing brief on Raymond T. Miles, Esq., 942 Ellicott Square, Buffalo 3, New York, Petitioner's counsel of record, on John G. Street, Jr., *amicus curiae*, 625 Fort Worth National Bank Building, Fort Worth, Texas, upon David Morgulas, *amicus curiae*, 521 Fifth Avenue, New York City, New York, and upon Edward M. Murphy, *amicus curiae*, 420 S. E. Jackson Street, Roseburg, Oregon, by depositing a copy of the same in a United States mail box, postage prepaid, addressed to each of the above counsel, at the post-office addresses set forth above, on October _____, 1962.

MARK N. TURNER,
Counsel for Respondent.